DOW THEORY LETTERS INC.

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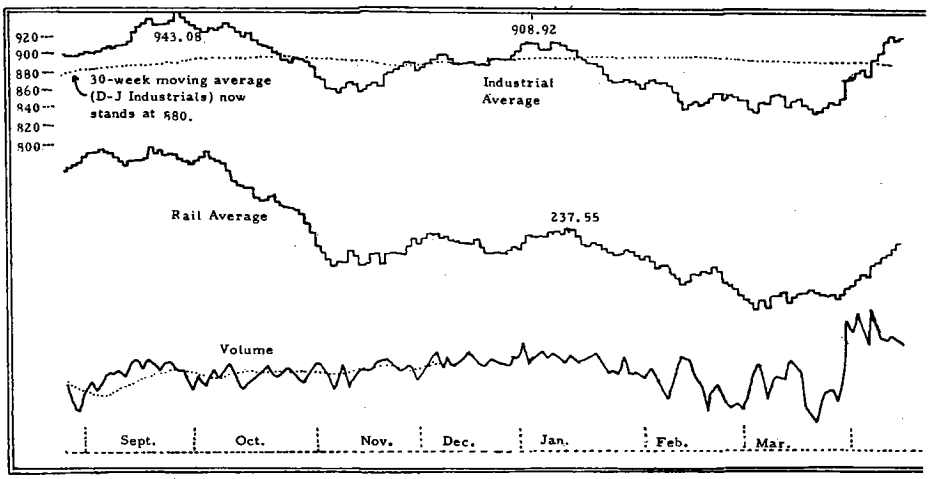
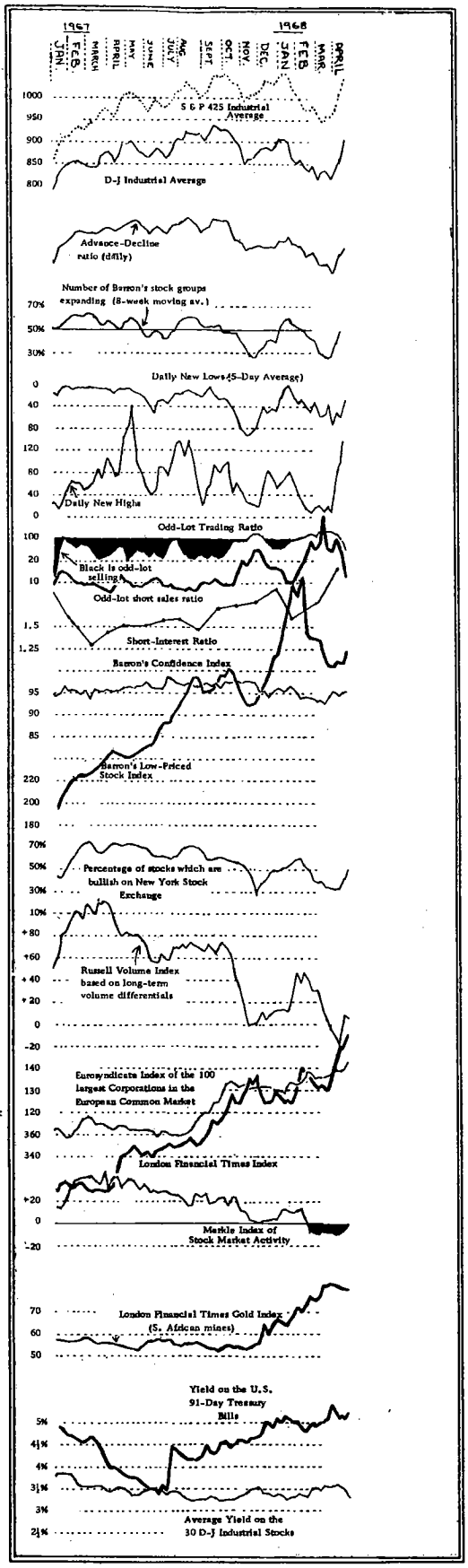
THE MARKET: The past two weeks, as explained in the last Letter, produced the greatest emotional buying spree in New York Stock Exchange history. It was a "crash" on the upside, and coming, as it did, within a primary bear market, it can be likened to the reverse of what occurred during 1953, 1957, 1960 or 1962. In each of those previous instances a severe and unexpected secondary (downward) reaction within a primary bull market succeeded in turning almost everyone bearish. But the final downward smash proved to be approximately the bottom of the reaction. Following these emotional clean-outs, the primary bull forces took hold again, and the market ultimately moved to new highs.

I would guess that the current April (upward) explosion will eventually work out much as 1953, 1957, 1960 and 1962—but in reverse. The 1968 buying "panic" came as a result of frantic emotionalism in response to news events. The events were the decision of "Hawk" President Johnson not to run for a second term, and the announcement of a partial cessation of the bombing in North Vietnam, preparatory (it is hoped) to genuine peace negotiations.

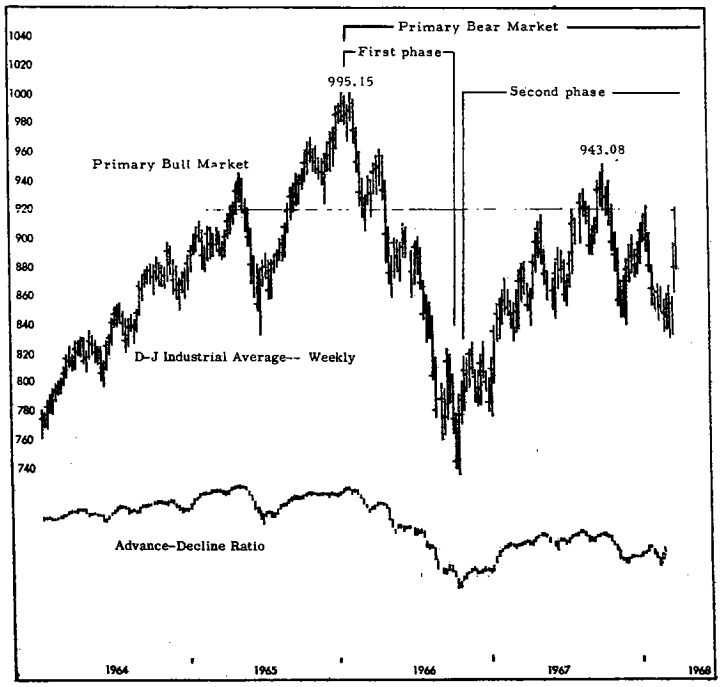
In a later section of this Letter the chances for real peace are discussed, but it is sufficient to say that peace will be most difficult and most costly. And the implications of what will have to be done and what will have to be given to gain peace are not clearly bullish. Furthermore, peace or not, the expenses connected with Vietnam will continue for years. On top of this, a further giant expense looms, an expense dramatized by the assassination of Dr. Martin Luther King. This expense is the billions of dollars which will be required for the rehabilitation of our cities (a necessity which is pressing on us more painfully with each passing month).

The money markets are already aware of the implications of a fantastically expensive peace (if indeed peace comes) and the need for many more billions to rebuild our cities. Last week the yield on the D-J 40-Bond Index was 6.67%, roughly at the high for 1968. This compares with the pitiful 3.29% yield on the 30-D-J Industrial stocks, a spread of 3.38% in favor of the 40-Bonds. The yield on Barron's 10 Highest Grade Bonds last week was 6.36%, better than 3% in favor of the highest grade bonds when compared to the yield on the 30 Dow stocks. As far as the bond-stock yield relationship is concerned, nothing has been corrected by two years of action in




1967
1968
S & P 425 Industrial Average
D-J Industrial Average
Advance-Decline ratio (daily)
Number of Barron's stock groups expanding (8-week moving av.)
Daily New Lows (5-Day Average)
Daily New Highs
Odd-Lot Trading Ratio
Black is odd-lot selling
Odd-lot short sales ratio
Short-Interest Ratio
Barron's Confidence Index
Barron's Low-Priced Stock Index
Percentage of stocks which are bullish on New York Stock Exchange
Russell Volume Index based on long-term volume differentials
Eurosyndicate Index of the 100 largest Corporations in the European Common Market
London Financial Times Index
Merkle Index of Stock Market Activity
London Financial Times Gold Index (S. African mines)
Yield on the U.S. 91-Day Treasury Bills
Average Yield on the 30 D-J Industrial Stocks

this primary bear market. But before the bear market is over, I would expect the bond-stock relationship to switch completely, with the 30 Dow stocks yielding perhaps 7% to 10% and bonds on average in the 3% to 4% yield area.



Secondary corrections such as the current one are always deceptive and emotional. When they occur within the second phase of a bear market, they are usually particularly deceptive (see chart). Therefore, it would be absolutely fruitless to speculate on how this particular correction will burn itself out. It may be that we will witness a "rounding top" structure of a few month's duration— or we may see a sharp drop, then a new push to or above the recent rally highs with a failure of one or the other Average to confirm. But the actual manner in which this rally dies is not important. What is important is that we have the patience and fortitude to avoid getting trapped in it. For bear market rallies are traps; that is their purpose.

Of course the technical conditions underlying this particular rally were exceedingly favorable. There was a huge short interest, there was odd-lot selling, there was pessimism regarding Vietnam and LBJ. And suddenly, the public changed its mind and decided it wanted in, not out. That change of mind brought in an unprecedented surge of emotional buying which saw the Industrial Average rise 80 points (on a daily closing basis) within 14 trading days. Thus the losses of the previous 49 days of bear market action (January through March) were almost wiped out in 14 trading days. This is action characteristic of bear market rallies, wherein the upside action is usually faster and more explosive than the action of the market as it follows its main trend (which in this case is down).

On April 15 the Industrial Average closed at 910.19, slightly less than 2 points above the January 8, 1968 high of 908.92. Rails, however, were still 7 points below their own January peak. What is the meaning of the Industrial penetration of the January high? As far as I am concerned, the emotional almost hysterical buying which pushed the Dow slightly above its early 1968 peak holds little significance. From the standpoint of Dow's Theory, the bettering of preceding secondary peaks by both Averages could imply a reversal of the primary trend if certain other conditions were met.

But such conditions include the sort of action which we associate with the termination of a bear market. This would require low volume, public apathy, pessimism on Wall Street, high yields on stocks, low margin accounts, and the bear market undergoing all three phases. Not one of these conditions now exists, so that I would say that even if the Rails do confirm by bettering their January high of 237.55, the move would be more emotional than meaningful. When volume on the N.Y.S.E. can reach 78 million shares in a week (which it did on the week ending April 5) anything can happen, and the implications of such action are at best subject to question. In 1957 the unreasoned (as was seen in retrospect) terror brought on by the Russian Sputnik plunged the Dow through two important reaction lows. The "bear signal" thus rendered was as suspect (and I said so at the time) as a "bull signal" would be if the Rails now confirmed the Industrial penetration of their January high.

VIETNAM: The most important economic, social and political factor in the U.S. today is the potential settlement of the war in Vietnam. In view of this, it would be worth examining both the optimistic and the pessimistic side of a possible settlement.

Optimistic: Here we must start with one fact. The actual military situation for the U.S. is now bleak. The expert opinion is that the military situation could not be restored to the pre-Tet (January, 1968) offensive position without another 200,000 Americans being sent to Vietnam. Such an escalation at this time would be politically impossible. It would also be economically impossible (short of destroying the dollar).

Therefore, negotiations (not a military victory) remain the only American avenue with which to end the war. North Vietnam announced that it is willing to talk, but only about a way to stop the bombing of the North. Nevertheless, one thing can lead to another. In renouncing the Presidency, LBJ has laid his head on a platter for Ho Chi Minh, and

to the Vietnamese (to whom "face" is important) this could mean something. Secondly, by announcing that he is not going to run again, LBJ has removed himself from political pressure, and has also "protected" himself from critics who impugn his motives.

Yet, as for negotiation, there is nothing in what Hanoi has said to imply that they will settle for less than dominant political power in Saigon. This is the least they will settle for, and once in power it would be only a matter of time before Saigon would ask the Americans to pack up and leave, lock, stock, and barrel.

Perhaps it might have been different if LBJ had pushed negotiations prior to the severe problems of the dollar— or before Hanoi's demoralizing Tet offensive. But now, with the Communists literally daring the U.S. to continue the costly war, it is fantasy to believe that Hanoi would settle for any less than its minimum terms— dominant political power in Saigon.

Pessimistic: The pessimistic side was put succinctly by the London Economist on April 6 when they said, ".....if the most pessimistic interpretation is right, the U.S. may be about to lose the position it has held since 1945, and the world is heading into a period of greater danger than anything it has known in the past 20 years."

By this the Economist is implying that the U.S. may be willing to accept defeat, rather than carry on a war which has already "broken the back" of a President, split the party in power, and spread dissention, suspicion and hatred across the face of America.

At this late stage in the game, it is a fact that if the Americans now accept defeat in Vietnam it will raise doubts about American commitments everywhere else in Asia and in Europe. There is little doubt but that if the U.S. now hands Vietnam over to Hanoi, the Russians and the Chinese will take this as a sign that they must, at the very least, adjust their thinking regarding American commitments throughout the world.

Does this sound as if I have changed my mind regarding the U.S. policies in Vietnam? I have not, but I feel that the U.S. should never have allowed the war to expand to the point where we had to choose victory or defeat. Vietnam was not the place for us to take a stand against the Communists. The issues were never clear, they were never accepted by the American people, and the undeclared war was shoved down the throats of an increasingly suspicious and rebellious American public. Now we must reap the results of the huge mistake which was Vietnam. We must choose victory or defeat. Defeat could mark the beginnings of new confrontations and new disasters. Victory may imply a continuation of the war on an even larger scale.

* * * *

I am afraid my conclusions regarding the whole war situation are not optimistic. It is obvious that if the negotiations break down, we will face a pessimistic picture all around. If the war continues on the old basis or if it continues on an expanded basis, few if any observers will take this as anything but bearish.

But what if we really sit down to serious negotiations? As I see it, to negotiate implies that we will have to give the Communists the minimum of what they want. "So what," say the doves, "the war will be over, and that is bullish."

I disagree. If the war had been brought to a conclusion two or three years ago we might have been able to develop something bullish out of the situation. But I do not see how anything bullish can come out of anything which the Communists will settle for now.

I will put it another way. The single concept which is almost universally accepted today is that "peace will be bullish." If there ever was a universally held opinion on Wall Street and everyplace else that is it. But I simply do not agree. I believe a perfect "contrary opinion" (with a bow to famed Contrarian Humphrey Neill) is that peace will be bearish. I do not think people are thinking this thing through. But peace now must be to a large extent on Communist terms. We have passed the point where we could obtain peace on our terms or even on a 50-50 basis. As I see it, the kind of peace which we can now hope for has momentous bearish implications. I believe that we will see this as the negotiations start and as they develop. I believe the market will also see it, and will reflect it in due time.

MORE VIETNAM NOTES: The shaky Saigon government is terrified by the thought of an American "betrayal." Informed observers expect the Saigon reigning powers to do everything possible to sabotage U.S.-Hanoi negotiations, and the current South Vietnamese total mobilization "implies" that if the U.S. pulls out, S. Vietnam may try to fight off the Communists alone. But the power base of Saigon's leaders is so tenuous that few believe the Government could hold up for long in the face of a U.S. pullout.

Perhaps the most telling commentary on the situation is this: Choice real estate values in downtown Saigon dropped 40% during the week ending April 8. If downtown Saigon real estate can be equated with Saigon's stock average, we can say that the market in South Vietnam crashed on the news that LBJ was not going to run and that the U.S. is ready to talk "peace."

THE SQUEEZE: While the gold picture subsides for the moment, the silver situation is getting ready to boil. Remember, there is an historical ratio between the value of gold and silver, and that ratio runs approximately 15 to 1. In other words, an ounce of gold is worth about 15 ounces of silver. When that ratio gets out of whack, pressure is put on the opposing metal. For instance, if silver goes to $3 per ounce, gold should be worth around $45 per ounce.

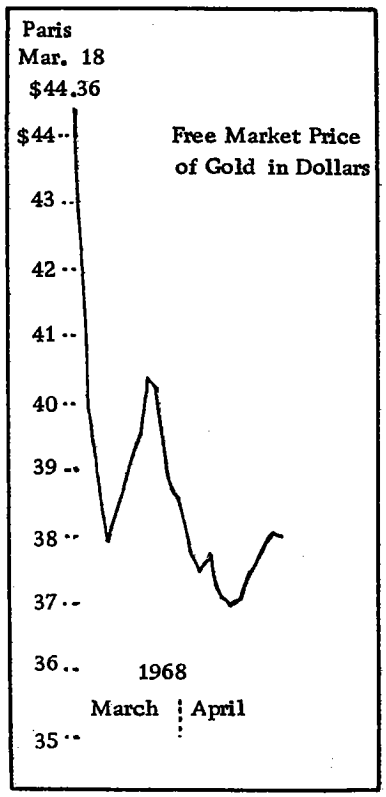
By law, on June 24, 1968, the U.S. Treasury is required to transfer at least 165 million ounces of fine (i.e. .999) silver to the U.S. defense stockpile. According to statistics and information obtained by Indicator Digest, there simply is not going to be enough silver to meet the dictates of the law.

Silver certificates will be honored by the Treasury up to June 24, 1968. Indicator calculates that by then silver certificates will take not less than 105 million ounces of fine silver. Subtracting this from the present supply of 275 million ounces of silver leaves 160 million ounces. But here is the catch. Only half of that 160 million ounces is in the fine state. The other half does not meet specifications of purity. To refine the rest of the silver would tax U.S. refining facilities and still take 2 to 3 years to refine.

The U.S. consumes around 165 million ounces of silver per year. This country produces about 40 million ounces of silver per year. Now although a part of the needed silver can be imported, there will nevertheless be a big gap. That gap in needed silver could begin putting upward pressure on the silver market at any time. Within a year, the upward pressure on silver could be terrific. And historically, upward pressure on silver puts upward pressure on gold. I expect the whole gold-silver situation, therefore, to flare up within the next two to three months.

As far as pressure on gold is concerned, turn to the next section.

NEW BAROMETER: This chart traces the daily price of gold, first in Paris while the London gold market was closed, and then in London after the London gold market was reopened. Here we see the $44.36 panic price registered in Paris on March 18, the recent early April low price of $37, and the slow steady rise in price ever since.



South Africa has announced that she is temporarily withholding all gold sales to the Central Banks and the free markets. It is not known when or how S. Africa will resume her gold sales, but the best bet is that she may sell part to the Central Banks at $35 per ounce and part to the private markets at the going price.

Aside from all this, what is important is that we now have an excellent barometer of the value of international paper money (as I now term the dollar). One may ask, what was the best showing for the dollar on the free gold market? Personally, I would guess the dollar's best showing occurred on April 5, when gold hit $37 in Paris. Gold has not been that low since.

However, there is little point in guessing which way the price of free gold will go. What is important is that we can now watch the price, which is in effect a barometer of hard, cold investment sentiment regarding the value of the dollar. Regardless of rumors, hopes or promises, the only thing which will cause gold to move up steadily is distrust of the dollar. If distrust continues, investment, speculative and hedging purchases will push the price of gold higher.

This chart will be kept up and included in later Letters. I will reprint the chart whenever I feel that it is saying something worth listening to. If the price of gold does start pushing up again, I would say that the late March high of $40.40 per ounce of gold is the first critical checkpoint to watch.

* * * *

Last week I received a letter from a subscriber in New Jersey, the contents of which I thought so important that I am reprinting part of that letter below:

"But the area which seems to me explosive is the free market in gold. It seems to me unbelievable that the price of gold will not rise on the free market, and I view all recent events bullish in this regard (contrary to the press and some of the services). It seems to me that the only jeopardy here is that the price of gold would fall below $35.20 per oz. on the free market. The action of the first week in April seems to me rather convincing against this event. Three most bearish events occurred in concert:

a-The President's peace offensive of March 31.
b-The seeming acceptance of SDR's at Stockholm.

c-The opening of the London market on April 1, with the attendent forced selling of those who bought gold to scalp a few points.

"My argument is that the abandonment of the Gold Pool, the creation of the two tier gold price structure creates a condition whereby the price of gold is no longer controlled by the International Monetary community. Regardless of whether the U.S., Belgium, Germany, Italy etc. want to maintain price stability in gold, the incentive lies not with them, but with what I call the Pro Gold Group, the same group which already broke a much more formidable array than a 700 million dollar a year supply. The consequences of this argument are that as soon as the weak sisters are shaken out, then the only supply is really South Africa. The price will rise. I expect maybe about 1 month to shake out, another month or two to generate liquidity and plan, so that within 60-90 days of April 1, I would expect to see the price of gold begin a meaningful march upward.

"When the price of gold reaches a high enough level, probably $50, or just above, the condition is created for arbitrage on the part of the Central Banks. U.S. will fight them by de facto embargo. Inconvertibility of the dollar really removes it as a reserve asset in the sense that it has been used in the gold exchange system. It is then up to foreign governments to determine what to do. It certainly means that foreign trade (as you have pointed out) will be severly hampered, since without dollar parity, and continued acceptance of the dollar by foreign central banks, the dollar will be subject to many free markets of supply and demand. This is chaos, and until either mutual agreement to raise the price of gold, or stability is attained in free market trading of dollars, another international crisis occurs.

"What I am saying is that Peace in Vietnam, SDR's and God's Will have no bearing whatsoever on what happens to the price of gold. As I see it, it's in the bag." (R.G. Morristown, New Jersey).

FLOATING DOLLAR: Few people are aware that there are now two kinds of dollars. One may be called an "official dollar." These are the dollars held by foreign central banks, dollars which are convertible (as long as not too many of them are converted) into gold at the rate of $35 per ounce of gold. Then there are the dollars which you and I own, and these may be termed "private dollars." Our dollars may not be converted into $35 gold. Yet our dollars are valued in terms of the free market price of gold, and if, for the sake of argument, gold on the free market runs up to $70 per ounce, our private dollars would be halved in terms of the price of gold.

In other words, our private dollars (since we cannot turn them in for $35 gold) are worth what the world markets say they are worth. For instance, at the current $38 price for gold, the dollar is being devalued by about 8.6%. If the price of gold goes to $40 the dollar will be devalued by about 14%.

Historically when a currency goes off gold, it is usually subject to constant fluctuations. When these fluctuations become violent, all sorts of trade and monetary problems arise. The less stable the currency, the more suspicion of it and the harder it is to deal with that currency. This is what the dollar faces with the two-tier gold system and the official and private dollars.

What it all amounts to is that the U.S. was not able to hold on to its gold because of its huge international deficits. Therefore, rather than lose its gold, the U.S. found it necessary to free the price of gold on the world markets. But if the U.S. deficits continue and if the world price of gold rises, it will only be a matter of time before foreign central bankers get disgusted and call in our remaining gold. If we embargo gold before then, we will have thrown in the sponge on the new system of "exchanging gold between friends" which was set up in Stockholm.

From reliable sources, I understand that few European bankers or financial experts believe that the two-tier gold system is going to work. Furthermore, many believe that there will be another gold run and dollar crisis within 90 days. It may be that the North Vietnamese are counting on this to aid them in getting what they want during negotiations. At any rate, from the standpoint of our European creditors there is little to cheer about in the present stance of the U.S. regarding its monetary problems.

NEWS ITEM OF THE WEEK: (from our "Just in case you missed it" Department) Item from the April 17 Wall Street Journal.

* * *

New York City awarded $98,140,000 various-purpose bonds to a First National City Bank group on an annual net interest cost basis of 4.9203% basis. This is the highest rate accepted by the city since it paid 5½% in 1932.

(Story on Page 25)

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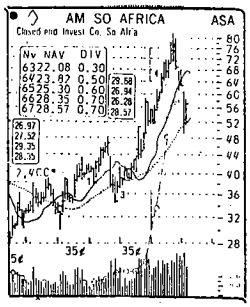
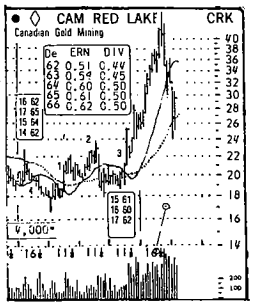
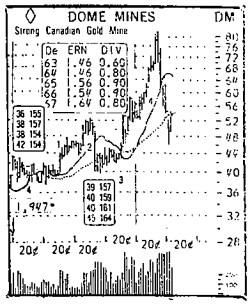
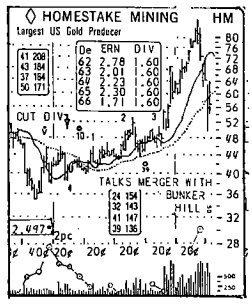
DOW THEORY MARKET LABORATORY PAGE









While the S. African gold average is back to within 6% of its 1968 high, most of the listed gold shares are simply retracing a part of their recent plunge from the March highs. Note on the weekly charts (courtesy of Quote Digest, 110 N. Lorraine, Wichita, Kans.) that all four listed gold issues corrected back to or slightly below the 200-day moving average (dotted line on chart). All four issues are now above the 200-day moving average— and are substantially above their recent lows.

What to expect next? I would expect another dip in the golds from current levels, then a second leg up, a leg which will take each issue above whatever highs may now be established. What happens after this second leg may be critical. If golds fail on the second leg to better the 1968 highs, I may suggest taking profits in half of our gold holdings. If, on the other hand, the gold shares are able to move to 1968 highs I will probably suggest that all our gold shares be held. We must remember two factors: (1) Although I doubt it, no one can prove that at their 1968 highs, the gold shares did not discount what I believe will be the coming devaluation, (2) with gold being made more freely available, investors may increasingly prefer to speculate in bullion itself rather than in gold shares.

One of the groups expected to reap a rich harvest from peace and a rebuilding of the cities is the Cement Group. Included is a daily chart of Lone Star Cement (courtesy of Traders Research, 101 Cherry St., Alton, Ill. 62002). Here we see accumulation in this stock with the March low holding above the December low (a performance which the Dow did not match) and the sudden appearance, over the past few weeks, of frenzied buying in this issue. The recent buying took the stock to a new 1968 high in a matter of days, and, in fact, Lone Star rose 20% in only three days of trading. Lone Star is one of the best issues in the Cement Group, and Cements would be one of the obvious beneficiaries of a peace and new "build the cities" spending program. The question I ask is whether what the buyers in the Cements foresee will actually come true. The action in Lone Star over the past two weeks has been emotional and explosive. Everyone wanted "in" at once. Lone Star topped out in 1957 at over 40. Following the next correction, even if LCE is not in a bull market of its own, it could go halfway back from the 1966 low of 14 to the old high of 40. Personally, however, although I still prefer to stay away from speculations (even intelligent ones) when the primary trend of the general market is down.